

**THE CITY OF LYNCHBURG**  
**Operational Review of Financial Services**  
**Accounting Division**

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**Accounting Division**

**Office of Internal Audit**

**February 28, 2001**

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***Introduction***

The Accounting Division within the Department of Financial Services is staffed by six Accountant III positions, a Cash Management Accountant and an Administrative Assistant who report to a City Accountant. The City Accountant reports to a Director of Financial Services. The City has recently hired a new director; however the position was vacant during the period of our review.

The Accountant III positions review and monitor activities within each fund, perform financial impact projections, revenue projections and expenditure analyses, prepare various required reports and schedules such as CWIP (Capital Work In Progress), grant reimbursements, unclaimed property, reconciliations and monthly AIM draws of bond proceeds. The accountants also assist other City departments, prepare journal entries for appropriations, transfers and adjustments. The Cash Management Accountant performs daily banking and investment activities, prepares journal entries, approves journal vouchers, reviews and posts cash reports, accounts payable and payroll batches, and balances the automated system.

***Audit Objectives***

The objectives of this review were to determine .....

- The appropriateness of work distribution,
- Performance of Non productive/unnecessary work,
- Performance of non cost-justifiable work,
- Duplication of duties,
- Appropriateness of the organizational structure,
- Appropriateness of reporting structure,
- Inefficient processes/systems
- Inadequate controls,
- Over/Under staffing, and
- Appropriate/inappropriate outsourcing.

### ***Audit Scope***

Our review of accounting operations covered the period of March 1 through September 30, 2000. It included reviews of spread sheets, reports, reconciliations, procedures and schedules. We also conducted interviews with the accounting staff to discuss the duties each of them perform. Specific areas of discussion were determined by reviewing time records the employees maintained of their daily activities for the month of March 2000.

Our review was conducted in accordance with professional internal auditing and generally accepted governmental auditing standards specified in the City's Internal Audit Charter, and accordingly, included such tests of records and other audit procedures as were considered necessary in the circumstances.

### ***Audit Observations***

- Accounting staff are performing some non-productive/unnecessary duties.
- Processes and systems are inefficient;
- The distribution of work prevents adequate cross training; and
- Some of the duties are inappropriately assigned;

### ***Issues and Recommendations***

#### ***I. Non-utilization of Automated Processes***

The Automated Financial Management System is not being utilized to best benefit the City in achieving complete, accurate and timely information. The following inefficiencies were noted during our review:

- A. The accountants prepare many manual spreadsheets for monitoring and reporting activities because the information cannot be readily retrieved from the automated system. Some of these spreadsheets, such as the CWIP Schedule (Capital Work In Progress), grant reimbursements, reconciliations and draw-downs of bond proceeds require numerous hours to monitor and update. New World Systems modules currently owned by the City have not been installed and implemented. Other modules have been implemented but not interfaced with the general ledger.

*The City's accounting code structure further contributes to the difficulty in extracting*

*data in necessary formats. Capital projects and grants are accounted for on the system in various funds and account codes and must be manually entered on the spreadsheets to determine total expenditures and balances. Further, the financial system does not indicate prior year expenditures or carry forward balances.*

*Monthly spreadsheets are prepared by bond issue for each fund and capital project. Each spreadsheet details appropriations, project-to-date expenditures, remaining appropriations, amount of bond proceeds previously drawn and the current draw amounts.*

- B. Spreadsheets are also prepared because the reports produced by the system are not in the appropriate format to facilitate requests for information. Data must be pulled from various funds/accounts and compiled manually.
- 3. Employees must review expense ledgers and pull all items which need to be posted to the Fixed Asset System since there are no specific accounting codes to indicate capitalizable items. In addition, the interface between the financial system and the Fixed Asset Module is inactive.
- D. The Department of Financial Services does not prepare the City's Annual Financial Statements. These are prepared by the external audit firm who performs the annual audit. With the use of the New World System's *Financial Reporting Module*, the City could reduce the annual contract fee by a considerable amount.

An automated financial system should produce the information for making management decisions in a useable format. The likelihood that errors will occur increases when information is manually transferred to spreadsheets. The *Project/Grant Accounting Module* of the New World System could eliminate the need to manipulate the data manually and help ensure that the information is accurate. The schedules and monthly draws of bond proceeds could also be performed in much less time if the module is implemented and interfaced with the general ledger. This will combine all activity across funds and maintain prior year balances for capital projects and grants. In addition, purchase and implementation of a report writer software package could facilitate the process of obtaining necessary information while ensuring the accuracy of the data.

*Recommendation:*

We recommend that the Director of Financial Services implement the *Project/Grant Accounting Module* of the New World System which was purchased in 1988. We also recommend that the Director work with the Department of Information Technology to purchase and implement a report writer software package that is compatible with the New World System. We further encourage management to consider purchasing the *Financial Reporting Module* to decrease the cost of the annual audit in future years.

### **Management Response:**

Concur in principle with recommendation a. Implementation of all multi-department projects to improve core services (i.e., a key City Council goal) is being prioritized by the BST to best utilize available City resources. At this writing, the revision to the Chart of Accounts (COA) and GASB #34 implementation have higher priority than Project/Grant Accounting. However, there is much synergy between both of the aforementioned projects and Project/Grant Accounting. Implementation of Project/Grant Accounting will begin in a staged manner, after the COA and GASB #34 are essentially complete.

The time frame to begin may approximate the first quarter of fiscal year 2002 / 2003, but is subject to change based upon competing and changing priorities. Resource challenges to be identified and provided will include, but are not limited to; assigning a full time project manager, identifying and providing the necessary funding and available time for multi-department tasks to include personal services requirements/other requirements, availability and funding of IT resources, implementing process improvements needed before the module is fully operational, and many others. Implementation may take between nine to twelve months and is dependent on many variables.

Concur in principle with recommendations b. and c. NWS has suggested to its clients the use of Crystal Reports as the report writer of choice for general use and for use in implementing GASB #34, the latter to include being able to effectively produce the more extensive full government reporting requirements. We have identified this need and have included approximately \$8.5k to purchase 17 packages within our Functionality Assessment, per reference (b), which has been provided to FSD's representative to the SLT and leader of the BST. This one-time amount will be considered, along with other such items, for mid-year budget adjustments. A note of clarification is needed at this juncture. Having a fully functional report writer will help FSD in general, and will help FSD work toward being able to prepare the annual report. But other more weighty factors will ultimately determine when the FSD can prepare the annual report in its entirety. These items include improving current processes and resultant data integrity to become more efficient and to become Generally Accepted Accounting Principles (GAAP) compliant, absolutely necessary and a prerequisite to becoming GASB #34 compliant. This concern includes being able to generate all the necessary adjusting journal entries now proposed by the CPA firm at year-end (i.e., in an automated environment not now conducive such as the Payroll system's inability to calculate automated accruals, etc.).

### **II. Inadequate Documentation**

We noted the following weaknesses in documenting and communicating policies and establishing procedures:

- Accounting policies and procedures are not in written form and distributed to City

departments. Since they are not clearly communicated, employees are not sure how to handle some transactions and accounting staff time is required to provide assistance and make corrections.

- There are few time schedules or deadlines established for submission of work to the Accounting Division. Corrections and/or transfers are not submitted by the departments on a regular monthly basis. This results in accountants spending more time monitoring funds and preparing journal vouchers at year-end, thereby extending the date for year-end closing.
- There are no lists of duties (functions/processes) performed by each position, and no scheduled times for performance of these duties to ensure that all work is completed in a timely manner.
- Procedures for the duties performed by accounting staff are not in written form. If in place, these procedures would be beneficial in training new employees or transferring duties to another accountant.
- Duties have been transferred among accounting staff and job descriptions have not been updated.

#### Recommendation

We recommend that a policy and procedures manual be prepared and distributed to the appropriate positions within each City department. The manual should include monthly and yearly cut-off dates for submitting work to the Accounting Division in order to ensure timely reporting of financial data. We also recommend that a list of the duties assigned to each accountant be prepared, that procedures for performing the duties be documented, and a schedule of due dates be prepared for each to ensure that all work is performed in a timely manner.

#### **Management Response:**

*Concur in principle with recommendations a. and b. Full implementation of written Finance and Accounting Policy and Procedures for City-wide use, as well as written “desk-top” procedures for use within FSD, is acknowledged but will take much time to develop. The crux of the problem is of course time. Time spent to produce FSD service deliverables versus time that can be spent to develop production capability. Developing written guidelines, although highly desirable, falls within that latter category. Reference (b) has shown that the FSD Accounting staff, for many valid (i.e., some of them beyond FSD control) reasons, is not able to keep up with its current work production.*

*We have many examples of this that we can share with you in another quorum. Suffice to say that our functionality must be taken care of first, before we tackle written guidelines. However,*

*the Directorate will begin to draft high level Financial Policy using the City's automated policy module. We suggest that Internal Audit assist the Director to identify areas that would be prime candidates for high level written Policy. It should be noted that FSD does have some written desktop procedures (e.g. for payroll, etc.).*

### III. Cumbersome Accounting Code Structure

The current accounting code structure includes numerous funds (some of which may be unnecessary) and excessive detail that is not useful in many instances. This complicates the process of coding financial transactions and prevents certain data from being compiled by the system in a useful format.

Each capital project is set up in a department as a sub-department in the appropriate funds. A project may have expenditures in several funds and departments, thereby making it difficult to compile all project costs on the automated system. Grants are also set up under various funds, departments, and sub-departments and separate codes are established each year for ongoing grants.

The Chart of Accounts further creates difficulty in completing the annual *Comparative Cost Report* which must be submitted to the Auditor of Public Accounts. Our coding system does not compile data by program area which is the format required for the report. Therefore, the data has to be manipulated and matched to the appropriate programs. We are currently paying our external auditors \$33,000.00 to prepare this report.

### Recommendation

We recommend that the Chart of Accounts be revised to simplify the processing of financial data. The revision should take into consideration all internal and external requirements for financial reporting. We further recommend that the *Project/Grant Accounting Module* be implemented. With this module, numerous codes would be eliminated and project information would be readily available.

### **Management Response:**

*Concur with recommendation a. Work has begun to revise the COA. The project manager has estimated that the project may take between six to nine months to complete. The FSD has requested a budget enhancement of \$65k to cover all costs associated with this project.*

*Concur in principle with recommendation b. Same as I. a above*

### IV. Non-productive/Unnecessary and non Cost-Justifiable Work

Some of the tasks currently performed by the accountants are either unnecessary or duplicate work that is performed in other areas.

1. In preparation for monthly draws of bond proceeds, accountants prepare spreadsheets that attach each capital project to a specific bond issue. It is not a requirement of bond counsel to identify the bond issues that fund specific projects; therefore unnecessary time is expended. This practice also increases the likelihood that arbitrage penalties will be incurred since the funds may not be expended as expediently as they should.
2. Accountants review, in detail, the grant reimbursement packages which are submitted by various City departments. Since the reimbursement packages are forwarded to and reviewed by the appropriate granting agencies, this practice appears to be unnecessary.
3. One position within the Accounting division verifies the accuracy of the automated system by running an adding machine tape of the new batches which were posted, adding the total to the previous Audit Control total and comparing to the current Audit Control Report.

**Recommendation:**

We recommend that capital projects not be specific to bond issues, but that one bond issue be totally expended prior to drawing from the next year's proceeds. We also recommend that the Department of Financial Services discontinue the practice of reviewing grant reimbursement packages and that the responsibility for accuracy be placed with the department preparing the request. We further recommend that the practice of verifying system computations be discontinued.

It is our opinion that there are other unnecessary tasks performed that did not surface in our review. We recommend that the Director of Financial Services review all current duties for appropriateness and cost effectiveness.

**Management Response:**

*Concur in principle with recommendation a. Although it may appear desirable and more efficient to eliminate these spreadsheets, our research indicates to the contrary. In fact, there are several valid reasons why they are prepared. First, they help size the bond issue by assigning projects to each issue. Second, they help eliminate the possibility of arbitrage rebate by facilitating analysis of each bond issue individually, and in the aggregate. If arbitrage problems are encountered, project history is promptly reallocated between bond issues, thus avoiding rebate. Because the City most often has more than one bond issue outstanding, one cannot simply attribute System generated monthly capital project expenditure totals to that issue,*



*when more than one bond issue exists. Thus, these spreadsheets serve as a cash management tool and a project-tracking tool to meet internal needs and IRS requirements, respectively. This process will be automated upon implementing Project/Grant Accounting. However, since the spreadsheets used to track City Capital and School bond issues to specific projects all interact using macros and other advanced Excel features, very little time is actually spent on them. We will, however, continue to review other FSD users of this process for efficiencies to be gained.*

*Concur in principle with recommendation b. As was the case above, it may appear desirable and more efficient to delegate review of grant reimbursement packages to the preparing department, however our research once again indicates to the contrary. For example, Public Works prepares highway grant reimbursement packages for FSD review. FSD performs a detailed review, uncovers numerous errors, which are communicated to Public Works to correct, prior to submission. These errors include under asking, and thus, if undetected, would cause a cash flow problem in that the amounts would probably not be reimbursable. In addition, FSD triggers Public Works to submit reimbursement packages because we are, in effect, tracking the cash flow requirements of the fund. In this case, the FSD Accountant spends only one hour per month in this mode. Thus benefit far exceeds cost. Other grant reimbursements such as Department of Criminal Justice and Office of Justice are actually prepared by FSD. There is a possibility that FSD could assign preparation to the Police department. However, since FSD has become proficient in the review process, FSD would still be inclined to review them for propriety, prior to submission. Still other reimbursement packages (i.e., Human Services) are prepared and submitted by the department. Implementation of Project/Grant Accounting would, once again, facilitate process improvement in this area, to include consistency across the entire City.*

*Concur in principle with recommendation c. Under normal circumstances, running adding machine tapes to validate systems produced audit control totals, once again, appears inefficient. However, the reliability of NWS continues to be suspect, such that “redundant” manual steps are at times prudent to perform. It should be noted that NWS has few, if any, automated controls that flag or prevent out of balance/tolerance transactions from being processed. We will review the automated control process, to the extent possible, with IT staff and NWS to gain further insight into the extent of reliance we can place on the control environment. It should be noted that the process mentioned takes very little time, and again, appears prudent under the circumstances. In fact, if not done, undetected errors would go unnoticed by the Fund Accountants until they reconciled their funds, which is not desirable because fund reconciliations are backlogged.*

*Concur with recommendation d. Work is underway via reference (b), and by other means, to identify areas of deficiency within the FSD. This type of review, however, once again fits the description of what is described in our response in II. a. and b. above. Every effort will be made by the Directorate to continue to review and assess FSD’s service deliverables for efficiency and effectiveness.*

#### V. Lack of Cross-Training

The work distribution within the division does not facilitate cross-training. There is little interaction between the accountants due to the distribution of duties by Funds instead of by processes or functions; therefore, general knowledge of the activities within the division is not shared. When one accountant is not available, there may not be anyone available who has sufficient knowledge to provide information or perform the duties.

#### Recommendation:

We recommend that the Director of Financial Services review the current organizational structure within the department and determine if the current work distribution is the most efficient and effective, and if it best serves the department's customers.

#### **Management Response:**

Lack of cross training. Review the current FSD organizational structure regarding efficiency and effective work distribution.

#### VI. Inappropriate Assignment of Duties

It is our opinion that some of duties performed within the accounting division may be inappropriately assigned and would better fit within areas outside of the division.

- The accountants perform reconciliations of general ledger account balances to subsidiary documentation that is maintained in the operations area where the transactions occur. Since the staff in that area would have knowledge of the subsidiary accounts, it is a better practice for them to assume responsibility for the accuracy of the entries to the financial system by performing the reconciliations.
- Some of the accountants spend a large portion of their time preparing information for the Budget Office and the City's Financial Planner. Revenue projections are prepared and continuously updated by accounting personnel. It is our opinion that this activity best fits within the budget area. Additionally, preparation for issuing bonds, sizing bond issues, preparing Official Statements and continuing disclosures, currently handled by an accountant in Financial Services, are duties which support the Financial Planner. The current work distribution may also interfere with planned work within the Financial Services Department as the Director of Financial Services may not be able to control work schedules or demands on the accountants' time.

### Recommendation

We recommend that the City Manager's Office and the Director of Financial Services review all of the duties currently performed by the accountants and determine whether they are general accounting functions, or whether some duties should be transferred to other operational areas within the City to allow for more effective processes and financial reporting.

### **Management Response:**

*Concur with the recommendation. Refer to our response in IV. d. above. In addition, several items are noteworthy. Once again, the FSD Director is in the process of a functionality assessment, per reference (b). This assessment is Citywide in scope because it considers all finance and accounting activities being performed, notwithstanding where the function is being performed. We do, however, take umbrage concerning the comments about the work FSD performs as adjunct to the City's Financial Planner. The scope of all of this work, as disruptive as it is to FSD productivity, still properly falls under the umbrella of a jurisdiction's financial function. In Lynchburg's case, the finance function has simply been divided between the FSD Director and the Financial Planner. The former, to expedite cross-functional process improvements, while the latter to provide broad fiscal guidance and communicate to external bodies. In time, the FSD Director will be able to migrate toward the Financial Planner's areas of expertise. Our great challenge is to work toward being fully productive with many tasks competing for staff time and attention, while at the same time finding time to plan production capability. At our present level of staff, this will be extremely difficult to do.*

### ***Other Comments***

We were unable to determine the effectiveness of the actual processes and distribution of work within the Accounting Division due to the lack of documentation. Since procedures were not in place for most of the tasks, there was no way to determine that they were appropriately assigned

and effectively performed. Our biggest concern with processes, however, is the lack of automated information which forces accountants to perform so many of the tasks manually. Without appropriate, reasonable accounting codes and complete, adequate automated systems, there is no way to properly align the duties of the accountants in a more realistic manner. Additionally, these manual tasks create a need for more accounting staff than would be necessary if the City's financial systems were more in line with today's technology.

We found the accounting staff within the Financial Services Department to be conscientious and dedicated in their job performances, and we appreciate the assistance they provided us during this review. We are available to discuss this report should there be questions or concerns.

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Shirley James, Senior Internal Auditor

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Carol J. Bibb, Director of Internal Audit